Assembly Bill 1434 (McCarty)
Date: 04/20/15
Program: Insurance Tax
Sponsor: California Department of Insurance
California Medical Association
Health and Safety Code (HSC) Section 1396.5 and Insurance Code (IC) Section 742
Effective January 1, 2016.

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This analysis only addresses the provisions that impact the Board of Equalization (BOE).

Summary: Transfers the remaining Knox-Keene Act preferred provider organizations (PPOs) to the jurisdiction of the Department of Insurance (DOI).

Purpose: To eliminate the loophole that allows only Blue Shield and Anthem Blue Cross to offer, market, or sell certain health insurance products, and still be exempt from the jurisdiction of the DOI.

Fiscal Impact Summary: Unknown.

Existing Law: The California Constitution imposes a 2.35% tax on insurers doing business in California. Commonly referred to as the "gross premiums tax," the annual insurance tax is based on insurers' gross premiums, less return premiums, for business done in this state. The California Constitution[1] specifies that the 2.35% tax is in lieu of all other taxes and licenses, with specified exceptions. Any person that meets this constitutional provision's "insurer" definition must register with the DOI and remit the annual gross premiums tax.

The Department of Managed Health Care (DMHC) is responsible for administration of the Knox-Keene Health Care Service Plan (Knox-Keene) Act[2] under which health care plan providers (including all health maintenance organizations (HMOs) and other persons or entities offering PPOs provided certain statutory requirements are met) are subject to California's general tax on corporations. Unless otherwise provided by law, corporations doing business or incorporated in California must pay a franchise tax equal to the greater of the minimum of $800 or an amount measured by net income multiplied by the current tax rate, which is 8.84%.

Health and Safety Code: HSC Section 1396.5 authorizes a nonprofit hospital corporation that substantially indemnified subscribers and enrollees, was operating in 1965 under Chapter 11A (commencing with Section 11490) of Part 2 of Division 2 of the Insurance Code, and regulated under the Knox-Keene Act to enjoy the privileges under the act which would have been available to it had it been registered under the Knox-Mills Health Plan (Knox-Mills) Act prior to its repeal (Assembly Bill 138, Chapter 941, Statutes of 1975) and applied for a license under the Knox-Keene Act in 1976.

Insurance Code: Section 742 subjects any person or other entity to the jurisdiction of the DOI if that person or other entity:

- Provides coverage in this state for medical, surgical, chiropractic, physical therapy, speech pathology, audiology, professional mental health, dental, hospital, or optometric services, whether this coverage is by direct payment, reimbursement, or otherwise, and
- Enters into an arrangement or contract with, or underwrites, a PPO or arrangement subject to Section 10133.

[1] Article XIII, Section 28.
[2] Chapter 2.2 (commencing with Section 1340) of Division 2 of the Health and Safety Code.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

IC Section 742 does not apply to any person or entity subject to regulation under the Knox-Keene Act. To date, Blue Cross of California and Blue Shield are the only two persons or entities registered under the Knox-Keene Act who also offer, market, or sell health insurance products.

Proposed Law: This measure repeals HSC Section 1396.5, and adds HSC Section 1396.6 to prohibit any Knox-Keene Act licensed entity from offering, marketing, or selling health insurance, as defined in IC Section 106(b). The prohibition applies to entities including, but not limited to, a PPO or arrangement described in IC Section 10133, whether issued on a group or individual basis, to an existing or new customer.

In addition, the bill amends IC Section 742 to delete the provision that excludes a person or entity subject to regulation under the Knox-Keene Act from being subject to the DOI's jurisdiction.

The bill becomes operative January 1, 2016.

Background:[3] In general, traditional (indemnity) health insurance and commercial indemnity coverage began to grow during World War II. At that time, wages were frozen, but benefits were not; therefore organized labor shifted their bargaining strategy to benefits instead of wages, resulting in the emergence of non-traditional (prepaid) health plans in California, such as HMOs. Around this time, the California Supreme Court concluded that certain prepaid health plans are not insurers, on the basis that they do not involve the element of indemnity, and, as such, are not subject to the jurisdiction of the DOI. (*California Physicians' Service v. Maynard Garrison, as Insurance Commissioner* (1946) 28 Cal. 2d 790, 804-805.) Subsequently, the Knox-Mills Act was enacted in the mid-1960's, governing certain health care service plans, to address the lack of regulatory framework for prepaid health plans in California.

In 1975, Assembly Bill 138 (Ch. 941, Knox) enacted the Knox-Keene Act, which established the basic health care regulatory framework that remains today. The Knox-Keene Act required all Knox-Mills plans to seek Knox-Keene licensure. In addition, Assembly Bill 138 required Blue Shield, a PPO, to obtain licensure under Knox-Keene, but gave it and several specialized plans three years to reduce the portion of their business that substantially indemnified subscribers (i.e., that involved insurance products). The Knox-Keene Act permitted both non-profit and for-profit plans, although most were non-profit. By 1985, there were 60 PPO plans in California.

Blue Cross of California continued to operate as a nonprofit hospital service plan under the Insurance Code throughout the 1970's and 1980's. In 1993, Blue Cross of California obtained multiple Knox-Keene licenses for health, pharmacy, and dental businesses. BBC's restructuring was complex and heavily debated legally, legislatively, and publically. Ultimately, an agreement was reached for Blue Cross of California to dedicate major corporate assets to charitable purposes and to maintain a single license as a for-profit health care service plan. In 1990, Senate Bill 785 (Ch. 1043, Robbins) added HSC Section 1396.5 to grant Blue Cross of California specific statutory authority under Knox-Keene, similar to the original authority provided for Blue Shield, allowing Blue Cross of California to continue offering PPO products.

Today, regulation and oversight of indemnity health insurance and prepaid health plan providers in California is split between two agencies. The Department of Managed Health Care primarily regulates Knox-Keene Act HMOs and two PPOs (Blue Shield and Blue Cross of California), while the DOI has jurisdiction over all indemnity traditional health insurance, except with respect to Blue Cross of California and Blue Shield.

[3] http://www.chcf.org/~/media/MEDIA%20LIBRARY%20Files/PDF/M/PDF%20MakingSenseManagedCareRegulation.pdf.

Commentary:

BOE responsibility remains the same. The BOE, DOI, and the Controller all contribute to the insurance tax administration. The Controller acts as a collector of any delinquent tax. The DOI primarily licenses, regulates, and audits insurers, and assesses and collects the tax amount each insurer is required to pay. The BOE issues DOI-determined assessments, refunds, and evaluates appeals.

Moving PPOs under the DOIs jurisdiction, which subjects such entities to the gross premiums tax, will not change the BOE's responsibilities.

Administrative Costs: The BOE's administrative costs relate to any assessment, refund and appeal evaluation workload associated with respect to PPOs transferred to the DOI's jurisdiction. A detailed cost estimate is pending; however, it appears this bill results in absorbable costs.

Revenue Impact:

The DOI assesses the gross premiums tax. As such, no revenue estimate will be provided as this is outside the BOE's insurance tax responsibility area.